MANNERS-KOESTERS MONITOR

Summer-The Heat is On! July 15, 2018

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More Art than Science

by Russ Manners

Another quarter in the books and overall stocks were up a little while bonds were down. The strength in several fast growing (now very large) companies has been making up for some weaknesses in the broader general market. So far this year we've made little forward progress, with several of our holdings (including Berkshire Hathaway down approximately 4%[1]) underperforming. We think we have good reason to believe this is temporary.

So what should we expect from your portfolios for the rest of the year and into the future? What's a reasonable return estimate to use for planning purposes? It's a good question and one we frequently get asked. In most of the detailed retirement plan reports prepared for our clients, we use what we think to be a fairly conservative estimate of 5% to 6%. However, we thought taking a little time to discuss portfolio return expectations in a little more detail might be helpful. To begin, it's probably wise to acknowledge that accurately forecasting what the stock market will do over the nearer term is as rare as unicorns. However, it's interesting that when we look at average stock returns in rolling ten year intervals (over many years) the numbers tend to smooth out ranging from about -3% to 20%[2]. If you use 20 year intervals, they compress a bit further ranging from about 6% to 18%[2]. So, will the next 15 years to 20 years in the US stock market be similar to the averages over the last 150 years? A period that includes the discovery of the polio vaccine, WWII, the Model T, the 1929 crash, Disneyland, JFK's assassination and the internet. We tend to think the current pace of change and the risks have never been greater, but the preceding list leads me to believe it's not foolish to assume we'll muddle through and perhaps even prosper in the future. To bet otherwise is probably the greater risk.

So if we use 9% to 10% as our best guess on the average total return of the stock holdings in your portfolio over the long term, then what should we use for your non-stock holdings? If we lump these into the category of bonds (including very short maturities) the historic returns, as one would expect, are less than stocks and much less volatile. Using the 20 year intervals again, we see average returns around 6%[2]. Similar to stocks, there are endless variables influencing interest rates and bond prices. Using these rudimentary numbers, we can talk about an overall portfolio return estimate based on how assets are allocated between stocks and bonds. For example, a 75% stock and 25% bond allocation might be expected to return about 8% over time:

75% invested in stocks returning 9% = 6.75%
+25% invested in bonds returning 6% = 1.5%

Average total return = 8.25%

So with hundreds if not thousands of caveats in mind, we come up with this 8% return estimate. We then factor in some investment costs, assume things could be a little worse than historic averages and see how things look for our clients with 5% or 6% rates of return over their expected life spans. Interestingly, many investment consultants have taken this simple math above to rather silly extremes (as financial "experts" are prone to do) and have sliced and diced the choices from my very basic stock and bond allocation to dozens of investment options.

These might include commodities, emerging foreign stocks, real estate, small company stocks, junk bonds and hedge funds. Without spending a lot of time on the effects of this line of thinking, we will simply say that large sums of private and public pension funds are invested based on the assumptions about future returns of these various asset classes. Not surprisingly, you've likely been reading about the wide spread problem of "underfunded" pensions as a result of overly optimistic assumptions. In this world, if you need to earn 10% to meet the retirement obligations of your workforce, you simply increase the percentage invested in categories where you assume higher future returns (and risks). Lately this includes categories like hedge funds and early stage social media companies. Unfortunately, these areas tend to have higher costs and are often illiquid.

We aren't very comfortable with this approach and prefer to stick with a little narrower focus of investment options for our clients. As you know, we prefer highly liquid stocks of more established companies with reasonably predictable businesses. We tend to favor bonds with similar characteristics. Staying away from higher cost, more exotic investment options has occasionally cost us a few percentage points of return, but over time, we suspect it's served our clients well... particularly during times of financial stress. We also think it's helpful to try and tailor our individualized portfolios to meet our clients' unique objectives as best we can. We spend time trying to plan for cash needs, charitable outlays, health issues, taxes and general comfort levels with portfolio volatility. So that's the longer version of the answer to the question of what kind of returns to expect. Unfortunately, it's a question not easily answered and like most questions about the future, requires a certain leap of faith. In the end, we suppose we're simply trying to be approximately right rather than precisely wrong.

1-Bloomberg

2-Thebalance.com/rolling-index-returns-1973-mid-2009-4061795

Team Charitable Volunteering

by Susan Koesters

Russ checking in the shoppers at

Open Door Mission!

During this last quarter, Kelli had a great idea for a team project. We signed up to volunteer at Open Door Mission, which is committed to breaking the cycle of homelessness and poverty. Each day, Open Door Mission's campus offers 816 safe, shelter beds to homeless men, women, and children, serves over 2,100 hot, nutritious meals, and provides preventive measures to more than 1,082 people living in poverty. For more details, you can visit www.opendoormission.org.

During our time, they asked us to help in their Outreach Center. This is where donated food, clothes, home furnishings, etc. are displayed on shelves for shopping by families in need. Russ, Jennifer and Kelli helped with the check-in process and verified certain information. There is no charge for any of the items and each person was given a limited amount of time to shop. Susan assisted in the grocery section and handed out a set number of items from each section. For example, a family of 4+ could have up to 2 selections from the pasta section and up to 4 cans from the fruit section. Meanwhile, other volunteers continually restocked the shelves. The time flew by as we visited with the shoppers and we really enjoyed our experience. It's also another reminder how all of us are fortunate and blessed to not live in poverty, which brings many added worries, stresses and challenges.

The Team heading out to work

at Open Door Mission!

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Jennifer's Journey Back in Time

June 5, 1968 – Robert F. Kennedy was shot and mortally wounded while leaving the Hotel Ambassador in Los Angeles. The shooting occurred after a celebration of Kennedy's victory in the California Presidential primary. He died at 1:44 am, June 6 at age 42.

July 1, 1862 – President Abraham Lincoln signed the first income tax bill, levying a 3% income tax on annual incomes of $600-$10,000 and a 5% tax on incomes over $10,000. Also on this day, the Bureau of Internal Revenue was established by an Act of Congress.

August 9, 1974 – Effective at noon, Richard M Nixon resigned the presidency as a result of the Watergate scandal. Nixon had appeared on television the night before and announced his decision to the American People. Facing possible impeachment by Congress, he became the only U.S. President to ever resign.

(source: The History Place™)

About Us

We look for businesses that we can truly understand and value. It is important to understand our "circle of competence" and stay within that circle no matter how promising a potential investment might appear. Sound investing requires discipline and the ability to keep emotions from corroding common sense — one of the greatest challenges to successful long-term investing. Our philosophy tilts towards well-established companies with solid balance sheets, good pricing power, and strong management. We have confidence in our ability to find quality companies that are run by proven management. We strive to act like business owners. We search for the characteristics that an actual long-term owner would seek in choosing to purchase of an entire business.

About D.A. Davidson

At D.A. Davidson Companies, we believe there is only one way to navigate through the wealth of financial services options: straightforward. We offer clear strategies with smart, personalized solutions that match your goals and show you the path to achieve them. We're with you every step of the way—leveraging our nationally-recognized research, capital market and expertise, and the largest network of financial advisors headquartered in the West. Our personal approach is rooted in the values, stability, and discipline of our 80-year-old employee-owned company that is as independent as you are.